

**REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND  
THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE  
INFORMATION OF NALEDI LOCAL MUNICIPALITY FOR THE YEAR ENDED  
30 JUNE 2009**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying financial statements of the Naledi Local Municipality which comprise the balance sheet as at 30 June 2009, income statement and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

**Responsibility of the accounting officer for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**Responsibility of the Auditor-General**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## **Basis for adverse opinion**

### **Fixed assets**

7. Fixed assets as disclosed in note 5 to the financial statements have been understated by the amount of R46 632 200 in the current year and R39 776 341 in the prior year. In addition to the understatement, sufficient appropriate audit evidence could not be obtained as to the completeness, rights of ownership, existence and valuation of the amount disclosed to the value of R166 513 815 (2008: R166 230 507) due to the following:
- a) According to the municipality's accounting policy, fixed assets are stated at "historical cost, or at valuation (based on the market price at date of acquisition), where assets have been acquired by grant or donation. While they are in existence and fit for use, except in case of bulk assets which are written off at the end of their estimated life as determined by the CFO and approved by Council". The following discrepancies were noted:
    - i) The existence of the Wepener swimming pool was physically verified and it was found that its condition had deteriorated over the years and consequently it was not fit for use. Sufficient appropriate evidence could not be obtained to confirm that management took action to improve the condition. The asset was still included in the fixed asset register which forms part of the historical costs of fixed assets as disclosed in the notes to the financial statements. The municipality did not perform periodic asset counts during the period under review. Had this asset been properly valued and written off as being unfit for use, the historical costs of fixed assets as disclosed in note 5 to the financial statements as well as loans redeemed and other capital receipts would have been reduced by R392 000. This was also reported in the prior year and no action was taken by the management of the municipality.
    - ii) Properties to the value of R46 718 745 in the current year and R40 338 470 in the prior year were identified in the valuation roll but could not be traced to the asset register; consequently, these were not included in the amount recorded in the financial statement as the asset register is the only record held by the municipality to support the fixed assets disclosed in note 5 to the financial statements. Had these assets been included in the financial statements, the amount disclosed in note 5 to the financial statements would have been increased by R46 718 745.
  - b) The municipality's accounting policy states: "Fixed assets held under finance lease are capitalised. Such assets are effectively amortised over the term of the lease agreements. Finance charges are allocated to accounting period over the duration of the leases, by the effective interest rate method which reflects the extent and cost of lease finance, utilised in each accounting period. All other leases are treated as operating leases and the relevant rentals are charged to the operating account in a systematic manner related to the period of the assets concerned". The amount disclosed in note 8 relates to the agreements entered into to lease office equipment, which constitutes finance leases and should be capitalised as fixed assets. These leases were not capitalised and the corresponding liability was not raised. Consequently, operating leases amounting to R933 468 in the current year and R505 296 in the prior year are overstated and fixed assets understated by the same amounts.

- c) The municipality entered into a service level agreement with an independent service provider to outsource the provision of electricity services. The service delivery agreement requires the electrical service provider to maintain bookkeeping and prepare the annual financial statements in respect of electricity provision to annually provide the municipality with the surplus or deficit in the operational account. The electrical service provider's confirmation of the surplus or deficit in the operational account includes a balance for fixed assets relating to assets of the municipality utilised by the service provider in fulfilling the terms of the agreement which was not considered during the preparation of the financial statements. This is as a result of a decision taken by management due to incorrect interpretation of the service level agreement and was not considered as a confirmation from the electrical service provider of the financial information of the municipality; consequently, fixed assets as disclosed in note 5 to the financial statements are understated by R 878 455.
- d) Included in note 5 to the financial statements are sundry assets with a negative balance as at 30 June 2009 amounting to R361 456. This is as a result of a journal processed through the appropriation account to reduce the balance of these assets by an amount of R594 675. Consequently, assets were understated and accumulated surplus overstated by R594 675.
- e) The showgrounds property was recorded in the asset register of the municipality at a value of R573 000. According to the valuation roll, this is not a property of the municipality as it is registered in the name of a private entity. Had the asset been removed from the asset register, fixed assets as disclosed in note 5 to the financial statements would have been reduced by R573 000. This was also reported in the prior year and no action was taken by the management of the municipality.
- f) The electrical service provider's asset register in the prior year reflects a vehicle with a value of R142 736 that was utilised by the electrical service provider in the municipal area. This vehicle was registered in the name of the parent municipality of the electrical service provider instead of the local municipality as it had been acquired with municipal funds. Although the vehicle was registered in the name of the electrical service provider's parent municipality, the municipality also included the vehicle in its asset register when the service provider confirmed the surplus or deficit in the operational account. This matter has been reported since the 2006-07 financial year and has still not been corrected by management. Had this asset been removed from the asset register, fixed assets for the prior year as disclosed in note 5 to the financial statements would have been reduced by R142 736.
- g) Assets disposed of in the prior year were still included in the asset register which supports the amount of fixed assets as disclosed in note 5 to the financial statements. Had these assets been excluded from the asset register, historical costs of fixed assets as well as loans redeemed and other capital receipts as disclosed in note 5 to the financial statements would have been reduced by R419 393.
- h) Management did not ensure that the municipality's fixed asset register agrees to the general ledger. A difference amounting to R 423 657 in the current year and R646 431 in the prior year was identified between the fixed asset register and the general ledger. Management could not provide the information and explanations I considered necessary to confirm the accuracy and completeness of fixed assets as disclosed. Accordingly, I was unable to determine whether any adjustments might have been necessary to the amount shown in the financial statements.

- i) Clinics to the value of R1 061 242 were not transferred to the Department of Health. Management did not adhere to the council resolution stipulating that clinics should be transferred to the provincial administration. I was unable to confirm or verify by alternative means that the title deeds were indeed transferred to the Department of Health. Accordingly, I was not able to determine whether any adjustments might have been necessary to the amounts shown in note 5 to the financial statements for fixed assets. This was also reported in the prior year and no action was taken by the management of the municipality.
- j) Fixed assets amounting to R7 008 736 could not be verified through physical inspection; consequently, I was unable to confirm the existence of these assets included in the financial statements. I was therefore unable to determine whether any adjustments might be necessary to the amounts shown in note 5 to the financial statements for fixed assets. The entity's records did not permit the application of alternative audit procedures regarding these assets.
- k) Included in the fixed asset register are properties to the amount of R98 567 749 in the current year and R6 381 323 in the prior year. The existence of these properties could not be confirmed, because the assets' generic description was not indicated in the asset register or the description that was included was not sufficient to enable the physical verification of these properties. The entity's records did not permit the application of alternative audit procedures regarding these assets. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in note 5 to the financial statements for fixed assets.
- l) Management was unable to provide sufficient appropriate audit evidence in respect of additions to fixed assets amounting to R266 115 in the current year and R23 276 680 in the previous year. In the absence of supporting documentation there were no reasonable alternative procedures that I could perform to confirm the valuation and existence of these fixed assets.
- m) Capital expenditure was incurred during the current year in respect of infrastructure projects to the value of R14 589 510 in respect of Wepener: Utility Sports Facility, Reservoir: Wepener, Riverside & Qibing: Waterbone Sanitation and Riverside: Waste Water Treatment Works but not recorded in the asset register. Management was unable to provide a list of all completed capital projects to ascertain whether they were included in the assets register. In the absence of sufficient appropriate audit evidence, I could not establish the extent of understatement of the historical costs of fixed assets as disclosed in note 5 to the financial statements. Accordingly, I could not perform any reasonable alternative audit procedures to determine the understatement of infrastructure assets.
- n) Sundry assets were included in the asset register at a total amount of R233 217 in the current year and R536 009 in the prior year. No supporting documentation could be obtained indicating individual assets that make up these amounts. In the absence of sufficient appropriate audit evidence, the entity's records did not permit the application of alternative audit procedures regarding these assets. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the existence and valuation of these fixed assets.
- o) I was unable to confirm the existence of vehicles to the value of R488 500 as the municipality's fixed asset register did not contain sufficient detail or unique

identification numbers. The entity's records did not permit the application of reasonable alternative procedures.

- p) Management was unable to provide me with sufficient appropriate audit evidence for journal entries recorded against the fixed assets in the prior year amounting to R34 788 139. In the absence of sufficient appropriate audit evidence, the entity's records did not permit the application of alternative audit procedures regarding the journals recorded against the fixed assets. Accordingly, I was unable to determine whether any adjustments might have been necessary to the amounts shown in the financial statements for fixed assets, surplus for the year and accumulated surplus.

#### Creditors

8. Creditors disclosed in note 12 to the financial statements are understated by R6 518 206. While the creditors were not accurately disclosed, sufficient appropriate audit evidence could also not be obtained as to the existence, completeness and the municipality's obligations in respect of creditors as disclosed in the financial statements amounting to R27 264 431 (2008: R25 836 462) due to the following:
- a) The creditors balance disclosed in note 12 to the financial statements included unspent conditional grants in respect of MIG as disclosed in note 27.2.2 to the financial statements. A number of incorrect accounting entries were noted in the calculation of unspent portion of these grants resulting in an understatement amounting to R3 125 482.
  - b) Included in creditors balance at year-end is an amount of R10 692 021 in respect of trade creditors. Instances were noted in this account where supplier statements did not agree to the amounts included in the supplier listing which was used to determine the account balance, resulting in an understatement of creditors as well as expenditure amounting to R749 390.
  - c) The applicable basis of accounting requires that the financial records be prepared on an accrual basis. Payments subsequent to year-end relating to invoices dated during the current year amounting to R1 969 570 were not recognised as creditors but only recorded in the next financial year. Consequently, creditors and expenditure are understated by the amount of R1 969 570.
  - d) The financial information of the municipality as contained in the confirmation from the electrical service provider was not considered during the preparation of the municipality's financial statements; consequently, creditors are understated by R673 764.
  - e) Instances were noted where expenditure and income in respect of the Drought Relief Grant, Financial Management Grant (FMG), Municipal Systems Improvement Grant (MSIG) and Municipal Infrastructure Grant (MIG) were incorrectly classified amongst these grants to the value of R2 365 885. Output VAT to the value of R757 842 was declared and allocated to the VAT account on zero-rated receipts. Management could not provide the amended financial statements reclassifying the expenditure and income for these grants and I could not determine the extent of this misclassification of the amounts disclosed in the notes to the financial statements. In the absence of updated schedules for the spending of grants, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was unable

to determine whether any adjustments might have been necessary to the amount shown in the financial statements for creditors.

- f) According to the records of the municipality, amounts to the value of R400 000 and R1 624 922 were received from the Department of Corporate Governance in respect of Drought Relief Grant and MSIG respectively. Management could not provide supporting documentation in respect of these grant allocations; consequently, I could not confirm their accuracy. In the absence of the necessary supporting documentation, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was unable to determine whether these amounts were accurately recorded against the grants.
- g) Management was unable to provide adequate supporting documentation relating to suspense accounts included in creditors to the amount of R5 198 517. In the absence of adequate supporting documentation, I was unable to confirm by alternative means the allocation of these suspense accounts in the creditors balance. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for creditors.
- h) Journals amounting to R11 582 445 in the current year and R13 847 074 in the prior year were processed against the creditors accounts for which no supporting documentation could be obtained. In the absence of sufficient appropriate audit evidence attached to the journals, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for creditors.
- i) Sufficient appropriate audit evidence could not be obtained in respect of payments to the amount of R2 303 336 made against the MIG as included in the balance for creditors at year-end. In the absence of supporting documentation, I was unable to confirm by alternative means the accuracy of unspent grants included in creditors balance. Accordingly, I was not able to determine whether any adjustments might be necessary to the amounts shown in the financial statements for creditors.

### **Expenditure**

- 9. Expenditure as presented in the income statement has been understated by the amount of R7 838 793. Furthermore, I could not obtain sufficient appropriate audit evidence for the actual expenditure presented in the income statement to the value of R31 450 264 (2008: R25 483 590). I could therefore not confirm the occurrence, completeness, accuracy and classification of expenditure due to the following:
  - a) The electrical service provider's confirmation indicated an amount of R8 848 204 in respect of expenditure which was not considered in the preparation of the financial statements for the municipality; consequently, expenditure is understated by R8 848 204.
  - b) The applicable basis of accounting requires that the financial records be prepared on an accrual basis. Included in expenditure as presented in the income statement is expenditure relating to services rendered and invoiced in the prior year to the amount of R814 211; consequently, expenditure is overstated by the same amount.

- c) Expenditure was incurred in the current year which was of a capital nature but incorrectly classified as general expenditure as presented in the income statement. Consequently, general expenditure is overstated and fixed assets understated by an amount of R195 000.
- d) Management could not provide adequate supporting documentation in respect of repairs and maintenance expenditure amounting to R194 963. In the absence of sufficient appropriate audit evidence, the entity's records did not permit the application of alternative audit procedures regarding these expenses. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the classification of this expenditure.
- e) Several instances were noted where VAT was not properly accounted for in respect of transactions with valid tax invoices. Management did not ensure that input VAT is claimed from the South African Receiver of Revenue. Accordingly, I was unable to determine the extent of unclaimed VAT and the impact thereof on overstatement of expenditure as presented in the income statement.
- f) In terms of the entity-specific basis of accounting, when the conditions of the grant are met, the expenditure incurred is transferred to expenditure in the income statement and the revenue equal to the expenditure is recognised. Instances were noted during the audit where the conditions of the grants were met but the expenditure and income were not recognised in the income statement. However, the extent of the misstatement could not be established due to weaknesses identified in the administration of grant expenditure. In the absence of proper controls surrounding the spending of conditional grants, I was unable to determine whether any adjustment might have been necessary to the amount shown in the financial statements for expenditure.
- g) Sufficient appropriate supporting documentation could not be provided by management for journal entries recorded against the expenditure accounts amounting to R1 256 703 in the current year and R592 294 in the prior year. In the absence of adequate supporting documents, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was unable to determine whether any adjustments might be necessary to the amounts shown in the financial statements for expenditure.
- h) Management could not provide sufficient appropriate supporting documentation for journal entries recorded against interest paid and interest received amounting to R1 096 554. The entity's records did not permit the application of alternative audit procedures. Accordingly, I was unable to determine whether any adjustments might be necessary to the amounts shown in the financial statements for expenditure.

#### **Accumulated surplus**

10. Accumulated surplus as presented in the balance sheet is understated by the amount of R6 926 720. Furthermore, I could also not obtain sufficient appropriate audit evidence for the balance disclosed in the balance sheet to the value of R25 198 708 due to the following:
  - a) The movement for the provision in bad debts was split by management between accumulated surplus (debtors outstanding relating to prior years) and the income statement. Management did not ensure that the transaction posted was accurate and correct. It was therefore noted that accumulated surplus was understated

by R5 338 887, income statement (expenditure) understated by R8 790 911 and provision for bad debts understated by R13 318 928.

- b) Assets amounting to R595 787 were written off during the current year. However, the transaction for the write-off was erroneously posted to accumulated surplus. Had the appropriate accounting entry been made, accumulated surplus would not have been affected but loans redeemed, and other capital receipts would have been decreased by R595 787.
- c) The confirmation from the electrical service provider included an amount of R561 273 in respect of the accumulated surplus which was not considered in the preparation of the financial statements for the municipality; consequently, accumulated surplus is understated by R561 273.
- d) A prior year error relating to unrecorded liabilities was incorrectly rectified by management. Corrections for unrecorded accounts payable to the value of R540 996 had been erroneously posted twice against retained earnings in the current year. Had the appropriate correction been made, accumulated surplus would have been increased by R540 096 and creditors would have been decreased with R540 096.
- e) A journal was posted by management against accumulated surplus to adjust the opening balance of the provision for leave. This is a result of a decision taken by management to address prior year audit findings; consequently, leave provision was erroneously increased resulting in leave provision being overstated and accumulated surplus understated by R331 511.
- f) Credit balances in consumer debtor balances were erroneously posted to the accumulated surplus at year-end. This is a result of a decision taken by management to exclude prepayments in the debtors balance to facilitate fair presentation of the financial position of the debtors balance at year-end; consequently, the accumulated surplus was overstated by R276 296 and creditors understated by R276 296.
- g) Accounting policy note 5.1 states: "The capital development fund ordinance of 1962, requires a minimum contribution of 1% of the defined income for the immediately preceding financial year". In fulfilling the requirements of the accounting policy, management incorrectly adjusted accumulated surplus by the amount of R64 538 instead of the capital development fund; consequently, accumulated surplus is overstated and the capital development fund understated by R164 538.
- h) Management could not provide sufficient supporting documentation for journals amounting to R951 274 recorded against accumulated surplus. In the absence of supporting documents, the entity's records did not permit the application of alternative audit procedures to confirm the journals recorded against this account. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the existence, completeness and valuation of accumulated surplus disclosed in the financial statements.

#### **Debtors**

- 11. Debtors as disclosed in note 10 to the financial statements have been understated by the amount of R8 250 912. In addition to the understatement, sufficient appropriate audit evidence could not be obtained as to the existence and

completeness of and the municipality's rights in respect of debtors to the amount of R24 674 972 (2008: R29 336 881) due to the following:

- a) Interest levied by the municipality on overdue accounts was not charged at the interest rates as prescribed by section 78(2)(a) of the Local Government ordinance. Due to the incorrect rate used by the municipality, income in respect of interest received and receivables are understated by an amount of R7 420 813.
- b) The electrical service provider's confirmation included the amount of R830 754 in respect of debtors, which was not considered in the preparation of the financial statements of the municipality; consequently, the debtors balance is understated by R830 754. It was established during the audit that, the debtors balance as included in the service provider's confirmation differs from the amount reflected in the age analysis by an amount of R143 321. Furthermore, included in the debtors balance reported in the service provider's confirmation are credit balances amounting to R89 077.
- c) During the recalculation of PAYE, it was noted that an amount of R965 232 was due to SARS. However, it was further noted that in total only R377 232 was paid over to SARS in respect PAYE; consequently, creditors and debtors are understated by R588 000.
- d) Council declared expenditure incurred by the staff without obtaining appropriate authority, and an overpayment to the service provider amounting to R137 853 and R132 695, respectively, as fruitless and wasteful expenditure and resolved that these amounts be recovered from the responsible officials and the service provider. These amounts were erroneously included in prepayments; consequently, creditors are overstated and receivables understated by R270 548.
- e) Included in the debtors balance at year-end are debtors with credit balances to the amount of R271 203. The municipality did not exclude these credit balances and report under creditors to facilitate fair presentation of the financial position of debtors balances at year-end. Consequently, debtors and creditors are overstated by R271 203.
- f) Management could not provide sufficient appropriate audit evidence in respect of journal entries recorded against debtor accounts amounting to R351 897 in the current year and R4 188 461 in the previous year. In the absence of sufficient appropriate audit evidence, the entity's records did not permit the application of alternative audit procedures; consequently, I could not determine whether these journals were in respect of bad debts written off or correction of an error. Accordingly, I could not establish whether any adjustment might have been necessary to the amounts shown in the financial statements for debtors and retained earnings.
- g) Explanations could not be provided by management for the following differences identified. In the absence of sufficient appropriate audit evidence, I was unable to confirm by alternative means the carrying value of debtors included in the financial statements. Accordingly, I was unable to determine whether any adjustments might be necessary to the amounts shown in the financial statements for debtors.
  - (i) A difference was noted between the age analysis at year-end and the debtor accounts in the general ledger amounting to R374 300 in the current year and

R483 187 in the previous year. Reconciliations were not performed between the debtors' sub-ledger and the general ledger.

- (ii) A difference was noted between the opening balance on the debtor accounts in the general ledger for the 2008-09 financial year and the closing balance on the debtor accounts in the general ledger for the 2007-08 financial year amounting to R245 778. In the prior year, a difference was reported between the opening balance on the debtor accounts in the general ledger for the 2007-08 financial year and the closing balance on the debtor accounts in the general ledger for the 2006-07 financial year amounting to R13 482 and no action was taken by management to correct these errors.
- (iii) A variance of R7 899 was identified in the prior year between the debtor amount disclosed in the financial statements and the amount in the general ledger.
- h) Included in consumer debtors in note 10 to the annual financial statements is an amount of R5 825 287 in respect of unallocated receipts. The nature of these receipts is unknown and these receipts have not been successfully allocated and followed up by management. In the absence of adequate supporting documents, I was unable to determine by alternative means the accuracy of the allocation of these amounts as debtors. Accordingly, I was unable to determine whether any adjustments might have been necessary to the amounts shown in the financial statements for debtors.

#### Income

12. Audit assurance as to the occurrence, completeness, accuracy and classification of revenue as disclosed in the income statement to the amount of R52 688 666 (2008: R45 679 709) could not be obtained. In addition to adequate supporting documentation which could not be provided, income was understated by the amount of R1 708 007 in the current year and R975 227 in the prior year due to the following:
- a) The electrical service provider's confirmation included an amount of R10 327 888 in respect of income that was not considered during the preparation of the financial statements of the municipality. Included in this income is an amount in respect of electricity sales to the amount of R3 536 973 which could not be agreed to the transaction billing of the electrical service provider. The transaction billing reflects the amount of R3 249 417, resulting in unexplained difference of R287 556. The reconciliation between the general ledger and the transaction billing could not be provided by the management of the electrical service provider and explanations for the difference could also not be provided. The amounts of R6 561 017 and R229 516 in respect of prepaid sales and prepaid electricity – Free services recoverable, respectively, were also included in the confirmation from the electrical services provider for which management of the electrical service provider could not provide adequate supporting documentation. In the absence of supporting documentation and acceptable explanations for the differences, no alternative audit procedures could be performed. Accordingly, I was unable to determine whether any adjustment might have been necessary to the amount of income as recorded in the confirmation from the electrical service provider.
  - b) Management was unable to provide me with sufficient appropriate audit evidence regarding to the journal entries recorded against revenue accounts amounting to

R3 110 169. In the absence of sufficient appropriate audit evidence, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was unable to determine whether any adjustments might be necessary to the amounts shown in the financial statements for revenue, deficit for the year and the accumulated surplus.

- c) Water meter reading registers in respect of water sales to the amount of R11 573 in the current year and R342 306 in the prior year could not be provided. In the absence of the meter reading registers, the entity's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the occurrence, accuracy and completeness of water income disclosed as revenue in the financial statements.
- d) A complete list/register for rotating electricity meters registered in the municipal jurisdiction could not be provided by management. In the absence of the register, the entity's records did not permit the application of alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to satisfy myself as to the completeness of revenue.
- e) An error on the water readings input onto the SAMRAS system resulted in a single water billing of R7 966 041 to a single customer and was included in water income as well as debtors. This error resulted in overstatement of income and debtors; however, the extent of the overstatement could not be established because management was unable to provide the accurate readings. In the absence of accurate readings, the entity's records did not permit the application of alternative audit procedures. Accordingly, I could not confirm the extent of the adjustment that would be necessary to the amounts shown in the financial statements for income, debtors and deficit for the year.
- f) Customers were billed for relevant services to the amount of R572 562. Management was unable to provide all the information and explanations I considered necessary to establish the extent to which the customers were not billed. In the absence of meter reading registers and due to the lack of reconciliations, the entity's records did not permit the application of alternative audit procedures. Consequently, the completeness of revenue and debtors as recorded in the financial statements could not be confirmed.
- g) The electrical service provider transferred an amount of R1 191 886 into the primary bank account of the municipality in respect of electricity provision to provide the municipality with the surplus in the operational account as agreed in the service level agreement. The deposit was not recorded in the general ledger of the municipality; consequently, income was understated and deficit for the year was overstated by the same amount.
- h) A grant in respect of equitable share amounting to R18 127 505 was deposited in tranches directly into the primary bank account during the current year. However, only R17 611 384 was posted to the general ledger. Management was unable to provide all the explanations I considered necessary for the difference of R516 121 not recorded in the general ledger; consequently, income recorded in the income statement was understated and the deficit for the year was overstated by the same amount.

- i) Interest to the amount of R1 096 554 paid in the prior year was incorrectly recorded in the financial statements as revenue instead of expenditure, resulting in revenue and expenditure being understated by the same amount.
- j) The amount recorded in the municipal financial records in the prior year in respect of prepaid electricity income was R4 229 959 (excluding VAT). However, the total amount indicated in the prepaid electricity information system of the municipality in respect of prepaid electricity sold was R4 069 541 (excluding VAT). Consequently, the revenue and retained surplus were overstated by R160 418.
- k) An amount of R586 704 was received in the prior year from the auctioneers for assets disposed of at an auction held on behalf of the municipality. This amount was recorded as profit on sales. This was actually the net amount received and not all of the amounts relating to this transaction were recorded. As a result, expenditure was understated by R111 143, revenue was understated by R39 091 and debtors overstated by R72 051.

#### **Salaries, wages and allowances**

13. Audit assurance as to the occurrence, completeness, accuracy and classification of salaries, wages and allowances as disclosed in the income statement to the amount of R12 170 253 (2008: R12 041 816) could not be obtained. In addition to adequate supporting documentation which could not be provided, salaries, wages and allowances are also understated by R2 620 357 and the note to the financial statements was understated by R6 368 131 due to the following:
  - a) Management could not provide adequate supporting documentation relating to allowances paid to employees to the amount of R421 568. In the absence of adequate supporting documents, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was unable to determine whether any adjustments might have been necessary to the amount shown in the income statement for salaries.
  - b) Sufficient appropriate audit evidence could not be provided for the difference amounting to R5 322 975 between the general ledger and the financial statements in respect of salaries, wages and allowances. In the absence of adequate supporting documentation I was unable to perform alternative audit procedures. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the occurrence and completeness of employee-related expenditure as disclosed in the income statement.
  - c) Salary run according to the payroll for the months of April 2009 and May 2009 to the amount of R1 830 778 was not included in the general ledger and consequently not recorded in the financial statements. This was because management did not perform monthly reconciliations between the general ledger and the payroll system. Salaries, wages and allowances as presented in the income statement are understated by the same amount.
  - d) Section 124(1)(c) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) stipulates that the notes to the annual financial statements of a municipality must include particulars of salaries, allowances and benefits of the municipal manager, the chief financial officer, every senior manager and such categories of other officials as may be prescribed. The amounts disclosed in note 15 and the

amounts according to the salary system did not agree. Management did not ensure that the amounts disclosed in the financial statements are comparable to the amounts per the salary system to ensure that the correct amounts are disclosed in the financial statements. Consequently, the note to the financial statements is understated by R789 579.

- e) Section 125(a),(b) and (c) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) states: "The note to the financial statement of the municipality must include the total amount of contributions to organised local government for the financial year, and the amount of any contributions outstanding at year-end, the total amounts paid in respect of pension and medical aid contributions, and whether any amounts were outstanding at year-end". Differences amounting to R6 364 131 were noted between the amounts reported in note 28 to the financial statements and the payroll data. Consequently, employee-related costs as disclosed in note 28 are understated by R6 363 131.

#### **Contingent liabilities and contractual obligations**

14. Management did not maintain an updated register in respect of contractual obligations entered into by the municipality; consequently the contractual obligations in respect of approved capital projects were not completely disclosed in note 25 of the financial statements. Management did not ensure that the information disclosed in the financial statements is accurate and correct. Consequently, contractual obligations are understated by R2 256 734 in the current year and R9 244 642 in the prior year and no action was taken by management to rectify this error.
15. Management was unable to provide sufficient appropriate audit evidence in respect of contingent liabilities disclosed in the note 25 to the financial statements amounting to R100 000. The contingent liability is in respect of a pending case instituted by the former municipal manager. In the absence of supporting documentation, the entity's records did not permit the application of alternative audit procedures to confirm the valuation of contingent liability as disclosed. Accordingly, I was unable to determine whether any adjustment might have been necessary to the amount shown for contingent liabilities.
16. It was established during the audit that a damage claim amounting to R550 000 was instituted against the municipality and was not disclosed in note 25 to the financial statements. Consequently, contingent liabilities as disclosed in note 25 to the financial statements are understated by the same amount.

#### **Cash and bank**

17. Journals amounting to R6 645 991 were processed against bank accounts in the current financial year for which no supporting documentation could be obtained. In the absence adequate supporting documentation attached to journals, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was unable to determine whether any adjustments might be necessary to the amounts shown in the financial statements for cash and bank balances.

#### **Long-term liabilities**

18. Individual loan agreements for capital purchases by the electrical service provider on behalf of the municipality could not be obtained. In the absence of loan agreements, I was unable to confirm by alternative means the carrying value of long-term liabilities disclosed in note 3 to the financial statements amounting to R992 661 in the current

year and R1 106 146 in the prior year. Consequently, I did not obtain all the information and explanations I considered necessary to confirm the existence, completeness and valuation of these long-term liabilities.

#### **Value-added tax**

19. Differences amounting to R6 885 203 were identified between the input VAT recorded in the general ledger and input VAT reflected on the monthly VAT 201 forms. In the absence of proper reconciliations and all the information I considered necessary, the entity's records did not permit the application of alternative audit procedures. Accordingly, I was unable to determine whether any adjustments might be necessary to the amounts included in the financial statements for VAT.
20. In terms of VAT Practice Note 2, issued on 25 September 2001, "The Supplier's VAT registration is required to be reflected on each tax invoice, debit note and credit note issued by him". Instances were noted during the audit where input VAT to the value of R157 178 was declared on transactions without a valid tax invoice. Furthermore, input VAT to the amount of R37 177 was not declared on transactions which were supported by valid tax invoices. Consequently, these amounts were not correctly classified between expenditure and the VAT control account. Due to lack of monthly reconciliations, management was unable to reclassify these amounts to enable the fair presentation of expenditure and the VAT control accounts. Consequently, I was unable to determine the extent of the misallocation between the expenditure and the VAT control. Accordingly, I was unable to determine whether any adjustments might have been necessary between the VAT control account and expenditure.

#### **Provisions**

21. The leave records of the municipality and its records of work attendance were not reliable for purposes of establishing the accuracy and completeness of leave to the credit of officials at year-end. The leave records were therefore not a reliable basis for calculation of the provision for leave as included on the balance sheet and disclosed in note 11 to the financial statements. I was thus unable to obtain sufficient appropriate audit evidence as to the valuation of the provision for leave amounting to R1 1014 562 in the current year and R803 550 in the prior year. In the absence of reliable leave records I was unable to perform alternative audit procedures to accurately determine the value of the provision.

#### **Contingent assets**

22. Management was unable to provide sufficient appropriate audit evidence in respect of contingent assets disclosed in note 26 to the financial statements amounting to R560 000. The contingent asset is in respect of a pending case instituted against the former chief financial officer. In the absence of supporting documentation, the entity's records did not permit the application of alternative audit procedures to confirm the valuation of contingent assets as disclosed. Accordingly, I was unable to determine whether any adjustment might have been necessary to the amount shown for contingent assets.

## **Inventory**

23. Water purchased for resale that was on hand in the reservoirs on 30 June 2009 was not included as stock on hand in the financial statements at year-end. The value of this stock could not be determined as no records of water levels could be provided by management. The amount of water on hand was included in the prior year amounting to R894 252. In the absence of adequate supporting documentation, I was unable to determine the valuation of inventory on hand at year-end to the value of R1 013 934 as disclosed on the balance sheet and in note 9 to the financial statements.
24. According to the municipality's accounting policy, inventory is valued at the lower of cost, determined on the weighted average basis, and net realisable value after due provision for obsolescence has been made. During the audit, it was established that items of inventory were recognised in the financial records on the invoice amount and not in accordance with the accounting policy. This has resulted in the misstatement of inventory as disclosed in the financial statements. However, the extent of the misstatement could not be ascertained.

## **Unauthorised expenditure**

25. Unauthorised expenditure is defined in section 1 of the MFMA as any expenditure incurred by a municipality otherwise than in accordance with section 15 or 11(3), and includes overspending of the total amount appropriated in the municipality's approved budget. Unauthorised expenditure to the amount of R3 145 725 was noted during the period under review as a result of overspending of the total appropriated amount for the municipality's budget. Furthermore, the amount appropriated for capital budget was exceeded by R5 255 405. This unauthorised expenditure was not disclosed in the financial statements as required by section 125(2) of the MFMA.

## **Irregular expenditure**

26. Irregular expenditure is defined in the MFMA as expenditure incurred by the municipality in contravention of or not in accordance with a requirement of this act, and which had not been condoned in terms of section 170; expenditure incurred by a municipality in contravention of or not in accordance with a requirement of the Municipal Systems Act and which had not been condoned in terms of that act; expenditure incurred by the municipality in contravention of or not in accordance with a requirement of the Public Office-Bearers Act, 1998 (Act No. 20 of 1998); or expenditure incurred by a municipality in contravention of or not in accordance with a requirement of the municipality's supply chain management policy or any of the municipality's by-laws giving effect to such policy, and which had not been condoned in terms of such policy or by-law. Irregular expenditure amounting to R1 810 673 was incurred by the municipality for the reasons detailed below and not was disclosed in the financial statements as required by section 125(2) of the MFMA:
- a) Expenditure was incurred to the amount of R1 439 278 without following the procurement procedures as required by the supply chain policy.
  - b) Employee-related expenses amounting to R371 395 were incurred without obtaining approval from the delegated official.

### **Fruitless and wasteful expenditure**

27. Fruitless and wasteful expenditure is defined in the MFMA as expenditure that was made in vain and would have been avoided had reasonable care been exercised. The municipality incurred fruitless and wasteful expenditure as detailed below amounting to R2 112 779 in the current year and R20 812 554 in the prior year and this expenditure was not disclosed in the financial statements as required by section 125(2) of the MFMA.
- a) Interest was paid on overdue accounts as the municipality was defaulting on a contractual obligation to the amount of R2 064 213.
  - b) The opening balance disclosed in note 29 to the financial statements did not agree to the closing balance of the prior year financial statements. Consequently, fruitless and wasteful expenditure disclosed in respect of the prior year is overstated by an amount of R9 858 000.
  - c) The official with an expired contract was still drawing salary and overtime payments from the municipality after the expiry date to the amount of R29 827.
  - d) Insurance premiums to the amount of R18 739 were paid in respect of officials' personal vehicles which were included in the insurance portfolio of the municipality.
  - e) Lease premiums to the amount of R34 889 were paid in respect of a lease after an expiry date.

### **Going concern**

28. The municipality experienced serious difficulties regarding debt collection and there were no plans to disconnect the services as the services were outsourced to an independent service provider. Furthermore, the municipality did not have plans to deal with undercollection as there was no bad debt or credit control policy in place. The debt collection period was significantly higher than the industry norm for other municipalities. The current and liquidity ratios have decreased compared to the previous year and the municipality might not be in a position to meet its current obligations in the normal course of business. The bank balance of the municipality deteriorated from a favourable bank balance in the prior year to a bank overdraft in the current year. The grants were utilised to finance day-to-day operations of the municipality other than those of the project management unit. The municipality was significantly dependent on the national and provincial government for its continued sustainability. This, along with other matters, points to the existence of a material uncertainty that may cast significant doubt on the municipality's ability to continue as a going concern. The municipality may therefore be unable to realise its assets and discharge its liabilities in the normal course of business. These are indicators that the municipality may possibly be facing serious financial problems in terms of section 138 of the MFMA. The financial statements did not disclose these facts.

### **Adverse of opinion**

29. In my opinion, because of the significance of the matters described in the Basis for adverse opinion paragraphs, these financial statements of the Naledi Local Municipality have not been prepared, in all material respect, in accordance with the basis of accounting as set out in accounting policy note 1.1.

### **Emphasis of matters**

I draw attention to the following matters on which I do not express an adverse opinion:

#### **Basis of accounting**

30. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

### **OTHER MATTERS**

I draw attention to the following matters that related to my responsibilities in the audit of the financial statements:

#### **Unaudited supplementary schedules**

31. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

#### **Non-compliance with applicable legislation**

##### **Municipal Finance Management Act, 2003 (Act No. 56 of 2003)**

32. Contrary to the prescripts of section 53(2) of the MFMA, the mayor did not promptly report to the municipal council and the MEC for finance in the province the delay in the tabling of an annual budget, the approval of the service delivery and budget implementation plan or signing of the annual performance agreements.
33. Management did not ensure that monthly creditor reconciliations are performed as required by section 65(2)(j) of the MFMA.
34. Contrary to section 64(3) of the MFMA, the municipality did not inform the National Treasury of the arrear accounts of the organs of state that are regularly outstanding for longer than 30 days.
35. The accounting officer did not ensure that all money owing by the municipality is paid within 30 days of receiving the relevant invoice or statement as required by section 65(2)(e) of MFMA.
36. Contrary to section 69(1)(a), the accounting officer did not take all reasonable steps to ensure that the spending of funds is in accordance with the budget and is reduced as necessary when the anticipated revenue was less than projected in the budget.
37. Contrary to prescripts of section 116(1)(b)(i) – (iii), contracts entered into by the municipality did not provide for the termination of the contract in case of under-performance, did not include dispute mechanism to settle disputes between parties, and did not provide for a periodic review of the contract once every three years in case of a contract longer than three years.

### **Municipal Systems Act, 2000 (Act No. 32 of 2000)**

38. Contrary to section 98 of the MSA, the municipality has not developed and adopted any by-laws to give effect to the municipality's credit control and debt collection policy and its implementation and enforcement.
39. Contrary to prescripts of schedule 1, section 5 of the MSA, councillors did not disclose to the municipal council, or to any committee of which the councillor is a member, any direct or indirect personal interest or private business interest, or the interest of any spouse, partner or business associate.
40. Employment contracts for the municipal manager and the managers directly accountable to the municipal manager could not be obtained. Consequently, I was unable to confirm that the municipality had complied with the requirement of section 57(a) of the MSA.

### **Municipal Structures Act, 1998 (Act No. 117 of 1998)**

41. It was established during the period under review that the council met only twice, which is contrary to section 37(c) of the MSA which prescribes that the council must meet at least quarterly.

### **Division of Revenue Act, 2007 (Act No. 1 of 2007)**

42. I could not confirm that the municipality had certified to National Treasury that it exclusively appropriated each programme funded or partially funded by the allocation of Municipal Infrastructure Grant in its annual budget as required by section 11(2)(a) of the DoRA.

### **Governance framework**

43. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

### **Internal control deficiencies**

44. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the adverse opinion. The root causes are categorised according to the five components of an effective system of internal control. (The number listed per component can be followed with the legend below the table.) In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for disclaimer of opinion	CE	RA	CA	IC	M
7.	Fixed assets	5,7	2,5	3,4,6		
8.	Creditors	5,7	1,2,5	3,4,6		
9.	Expenditure	5,7	1,2,5	3,4,6		

10.	Accumulated surplus	5,7		3		
11.	Debtors	5,7	1,2,5	3,4,6		
12.	Income	5,7	1,2,5	3,4,6		
13.	Salaries, wages and allowances	5,7	1,2,5	3,4,6		
14 – 16.	Contingent liabilities and contractual obligations	5,7	1			
17.	Cash and bank	5,7	1,2,5	3,4,6		
18.	Long-term liabilities	5				
19 – 20.	Value-added tax	5,7	1,2,5	3,4,6		
21.	Provisions	5,7	1,2,5	3,4,6		
22.	Contingent assets	5,7	1			
23 – 24	Inventory	5,7	1,2,5	3,4,6		
25.	Unauthorised expenditure	5,7	1,2,5	3,4,6		
26.	Irregular expenditure	5,7	1,2,5	3,4,6		
27.	Fruitless and wasteful expenditure	5,7	1,2,5	3,4,6		
28.	Going concern	5	1			

#### Overall reflections on the governance framework based on internal control deficiencies

45. Inadequate leadership due to instability in the position of the municipal manager and the chief financial officer has resulted in insufficient monitoring and supervision in finance section. Finance staff were in acting positions for a significant portion of the year and did not accept adequate responsibility; consequently, records with underlying information to support the preparation of the financial statements were not adequately managed.
46. Lack of discipline in the supply chain management directorate resulted in numerous instances of non-compliance with applicable legislation which the municipality's internal processes did not prevent or detect. This, in turn, resulted in irregular, fruitless and wasteful as well as unauthorised expenditure. The municipality did not have a plan to address prior year qualifications.
47. Political instability within the council resulted in ineffective oversight because council meetings were not held.

Legend	
CE = Control environment	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
RA = Risk assessment	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3

The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
<b>CA = Control activities</b>	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
<b>IC = Information and communication</b>	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
<b>M = Monitoring</b>	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self-assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

### Key governance responsibilities

48. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
<b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.		X
<b>Quality of financial statements and related management information</b>			
2.	The financial statements were not subject to any material amendments resulting from the audit.		X
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.	X	
<b>Timeliness of financial statements and management information</b>			
4.	The annual financial statements were submitted for auditing as per the legislated deadlines in section 126 of the MFMA.	X	
<b>Availability of key officials during audit</b>			
5.	Key officials were available throughout the audit process.		X

No.	Matter	Y	N
<b>Development of and compliance with risk management, effective internal control and governance practices</b>			
6.	Audit committee		
	<ul style="list-style-type: none"> <li>The municipality had an audit committee in operation throughout the financial year.</li> </ul>		X
	<ul style="list-style-type: none"> <li>The audit committee operates in accordance with approved, written terms of reference.</li> </ul>		X
	<ul style="list-style-type: none"> <li>The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.</li> </ul>		X
7.	Internal audit		
	<ul style="list-style-type: none"> <li>The municipality had an internal audit function in operation throughout the financial year.</li> </ul>		X
	<ul style="list-style-type: none"> <li>The internal audit function operates in terms of an approved internal audit plan.</li> </ul>		X
	<ul style="list-style-type: none"> <li>The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.</li> </ul>		X
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.		X
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.		X
10.	The information systems were appropriate to facilitate the preparation of the financial statements.		X
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA.		X
12.	Powers and duties have been assigned as set out in section 79 of the MFMA.		X
<b>Follow-up of audit findings</b>			
13.	The prior year audit findings have been substantially addressed.		X
14.	SCOPA resolutions have been substantially implemented.		X
<b>Issues relating to the reporting of performance information</b>			
15.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.		X
16.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.		X
17.	An integrated development plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the department against its mandate, predetermined objectives, outputs, indicators and targets (section 68 of the MFMA).		X
18.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.		X

#### Overall reflections on the governance framework based on other key governance requirements

49. Significant delays were experienced in obtaining the requested information due to leadership instability as the municipal manager and the chief financial officer were only appointed after year-end. There were no responsible officials to hand over to the new incumbents as previous officials had since left the municipality and those that

were still available did not accept such responsibility as they were appointed in acting positions. Differences in leadership philosophy between the municipal manager and the chief financial officer also contributed to delays in obtaining the requested information.

50. The financial statements were subject to material corrections resulting from the audit but the management decided not to rectify these errors which resulted in an adverse opinion being issued for the municipality. Although the municipality engaged consultants in preparing the financial statements, the underlying accounting records of the municipality did not facilitate the preparation of the financial statements to comply with the accounting framework.
51. The annual report was not submitted timely for consideration due to lack of capacity in the municipality to assign the responsibility for the preparation of the annual report to the delegated official. Furthermore, the municipality does not have a process in place to collate the information from the various departments for the preparation of the annual report.
52. Key officials were not available throughout the audit process as management did not prioritise their involvement in the audit process against service delivery initiatives, preferring to attend other engagements to resolve legacy issues created by the previous management.
53. The audit committee did not exist during the period under review due to challenges faced by the municipality to finance the vacant positions and also to attract incumbents with relevant expertise to fill the positions on the committee.
54. The internal audit unit did not exist during the period under review due to challenges experienced by management to finance and attract incumbents with the necessary skills and expertise who were willing to relocate to the Naledi local municipal area.
55. Internal controls were not designed in respect of financial and risk management because management did not prioritise the appointment of a risk officer. Furthermore, there were no internal controls with regard to non-compliance with applicable laws and regulations due to the non-existence of an internal audit unit and a lack of monitoring and supervision.
56. The risk assessment was not performed during the period under review as the accounting officer did not prioritise the appointment of a risk officer.
57. Prior year audit findings were not addressed due to insufficient monitoring and reconciliation of the financial records. Management did not develop an action plan to address the qualifications reported in the prior years.
58. SCOPA resolutions were not substantially implemented because resolutions were not prioritised and addressed by management. Furthermore, due to the absence of an internal audit unit, no independent reviews were performed to ensure that SCOPA resolutions are implemented.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **Reporting on performance information**

59. I was engaged to review the performance information.

### **The accounting officer's responsibility for the performance information**

60. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000).

### **The Auditor-General's responsibility**

61. I conducted my engagement in accordance with section 13 of the PAA read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*, and section 45 of the MSA.

62. In terms of the foregoing, my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

63. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

### **Findings on performance information**

#### **Non-compliance with regulatory requirements**

#### **No quarterly reporting on performance information**

64. No quarterly reports were prepared by Naledi Local Municipality on progress made in achieving measurable objectives and targets to facilitate effective performance monitoring, evaluation and corrective action, as required by section 72(1) of the MFMA.

#### **No reporting on performance information**

65. The annual report of the municipality did not include the annual performance report prepared by the municipality in terms of section 46 of the MSA, as required by section 121(3)(c) of the MFMA.

#### **Content of integrated development plan**

66. The integrated development plan of the municipality did not include the key performance indicators and performance targets set in terms of its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001.

### **Existence and functioning of a performance audit committee**

67. The municipality did not appoint and budget for a performance audit committee, nor was another audit committee utilised as the performance audit committee, as required by regulation 14(2) of the Municipal Planning and Performance Management Regulations, 2001.

### **Internal auditing of performance measurements**

68. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurements as part of its internal audit processes, as required in terms of section 45 of the MSA.

### **Lack of implementation of performance management system**

69. The municipality did not implement a framework that describes and represents how the municipality's cycle and processes of performance planning, monitoring, measurement, review, reporting and improvement would be conducted, organised and managed, including determining the roles of the different role players, as required by regulations 7 and 8 of the Municipal Planning and Performance Management Regulations, 2001.

### **No mid-year budget and performance assessments**

70. The accounting officer of the municipality did not assess the performance of the municipality during the first half of the financial year, taking into account the municipality's service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

### **Usefulness and reliability of reported performance information**

71. The following criteria were used to assess the usefulness and reliability of the information on the municipality's performance with respect to the objectives in its service delivery budget implementation plan and integrated development plan:
- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved annual performance plan/integrated development plan?
  - Relevance: Is the performance information as reflected in the indicators and targets clearly linked to the predetermined objectives and mandate? Is this specific and measurable, and is the time period or deadline for delivery specified?
  - Reliability: Can the reported performance information be traced back to the source data or documentation and is the reported performance information accurate and complete in relation to the source data or documentation?

The following audit findings relate to the above criteria:

**Performance information not received in time**

72. An assessment could not be performed of the reliability of the reported performance information, as set out on pages XX to XX of the annual report, since the information was not received in time for audit purposes.

**APPRECIATION**

73. The assistance rendered by the staff of the Naledi Local Municipality during the audit is sincerely appreciated.

*Auditor-General*

Bloemfontein

10 February 2010



AUDITOR-GENERAL  
SOUTH AFRICA

*Auditing to build public confidence*